STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Verizon North Inc. and Verizon South Inc.	)	
	)	Docket No. 02-0560
Verified Petition for Certification Pursuant	)	
to 220 ILCS 5/13-517 or Waiver Pursuant	)	
to 220 ILCS 5/13-517(b)	)	

Public

Surrebuttal Testimony of

DENNIS B. TRIMBLE

Executive Director - Regulatory

On Behalf of
Verizon North Inc.
Verizon South Inc.

January 22, 2003

Verizon Ex. 7.0

Q. Please state your name, business address and title.

A. My name is Dennis B. Trimble. My business address is 600 Hidden Ridge, Irving, Texas, 75038. I am employed by Verizon Services Group Inc. as Executive Director - Regulatory and am representing Verizon North Inc. and Verizon South Inc. (jointly referred to as Verizon or the Company) in this proceeding.

Q. Are you the same Dennis B. Trimble that submitted Direct and Rebuttal testimonies in this Docket?

A. Yes.

Q. What is the purpose of your Rebuttal Testimony?

A. My testimony will address the issues and concerns that I have with the rebuttal testimonies of the Illinois Commerce Commission (ICC) Staff and the Office of the Attorney General of Illinois (Attorney General).[1] Specifically, I will address allegations that (1) Verizon did not provide sufficient information to evaluate its waiver request, (2) Verizon overestimated the going-forward costs involved in complying with Section 13-517(a) of the Illinois Public Utilities Act, and (3) Verizon underestimated the revenues it would generate based on the incremental deployment of capital that would be required to be in compliance with Section 13-517. In addition, I will provide some general comments regarding various issues surfaced by the ICC and Attorney General witnesses.

Q. Did any information contained in the Rebuttal Testimonies of the various witnesses have any material impact on Verizon's positions in this proceeding?

[1] Filing rebuttal testimonies on behalf of the ICC were Mr. Mark Hanson, Ms. Qin Liu, Dr. James Zolnierek, and Ms. Janice Freetly. Filing rebuttal testimony on behalf of the Attorney General was Mr. William Dunkel.

A. No. Both the ICC Staff and the Attorney General witnesses' testimonies contained recommendations based (to the most degree) on financial computations that each party performed. As I will show later, each party's financial estimates were based on severe computational errors that would necessarily lead to erroneous policy determinations. Verizon's position is unchanged - any mandated requirement to deploy facilities so that DSL transport capabilities may be offered to 80% of the Company's customers would be "unduly economically burdensome" (to either the Company or its customers). Likewise, Verizon's position is absolutely supported by the information and analyses Verizon has submitted in this proceeding.

Q. What other parties have intervened in this proceeding?

A. Village of Mt. Zion, Gary Lambert, the Illinois Attorney General (AG), and the Citizens Utility Board (CUB). In addition an exparte letter has been filed by Robert Rubendunst, a small business owner.

Q. Could you provide your understanding of the status of these parties' intervention?

A. First, I believe that it's worthy to note that Verizon published notice of its filing in 23 major news papers through out its operating territory, for three consecutive days. In addition, Verizon made approximately seven hundred thousand (700,000) direct mailings to end users advising them of the reasons for the filing, as well as their opportunity to participate in this proceeding. As a result of this extensive customer notification, only two people (other than CUB/AG) intervened in this case.

CUB/AG is an active participant in this proceeding, represented by William Dunkel, and has filed Rebuttal Testimony. The remaining intervenors, as well as Mr. Rubendunst, have been contacted by Verizon representatives, and have been provided information on the services currently available in their respective areas.

Q. How is your remaining testimony organized?

A. My remaining surrebuttal testimony is comprised of eight sections. Section II will address various general areas of concern. Section III will discuss the ICC Staff's overarching position that Verizon's filed information was deficient to the extent that Verizon should not be granted its alternative waiver request, as specified. Section IV will address the ICC Staff's concerns regarding Verizon required capital and annualized cost estimates. Section V will address the ICC Staff's alternative financial estimates. Section VI will address the Attorney General's alternative financial estimates. Section VII will address various parties' issues regarding Verizon's financial assumptions. Finally, Section VIII will provide a brief summary of the salient points of this testimony,

Q. Please summarize Verizon's overall presentation in this proceeding?

A. First, I must reiterate that Verizon's primary position is that the Company is currently in compliance with Section 13-517, and as such is requesting that the Commission certify the Company as being compliant. Verizon currently offers and provides services capable of supporting, in at least one direction, a speed in excess of 200 kilobits per second to the network demarcation point at the subscriber's premises in all of its service areas . The additional requirements proffered by Staff are not required by Section 13-517. If the Commission determines that the Company is not compliant, then Verizon's request for a full waiver is based on the fact that deployment of DSL transport capabilities (a federally regulated service over which the ICC has no jurisdiction) to 80% of Verizon's customer base would either (a) have a significant adverse economic impact on end users, and/or (b) be unduly economically burdensome to the Company, and/or would otherwise be impractical.

Q. What financial data did Verizon file in support of its waiver request?

A. Verizon filed estimates of the overall capital requirements (total and annualized) as well as the annual operating expenses that would be incurred to deploy DSL transport capabilities to current non-DSL areas to an extent that would allow the Company to offer DSL transport capabilities to 80 + percent of its customer base. Based on the Company's assumptions, the incremental costs of such activity are significantly higher than the expected incremental revenues, resulting in an undue economic burden to either the ratepayers of Illinois and/or the Company.

Q. Did Verizon submit the total costs and estimated revenue data associated with offering DSL transport services to 80% of the customers in Illinois?

A. No. Verizon only submitted the incremental costs and potential revenue estimates for going-forward deployments (e.g., deployments that were not planned to occur before year-end 2002) that would be required to achieve the 80% threshold of Section 13-517. Costs incurred prior to year-end 2002 were not included in Verizon's financial presentation (likewise, neither were any associated revenue estimates.) Verizon's request for a full waiver is based on an incremental financial analysis. Verizon is not requesting a waiver for geographic areas in which the Company already has ubiquitous DSL transport capabilities; such a waiver would make no sense.

Q. Isn't Verizon's request really for a partial waiver of Section 13-517?

A. That is a matter of semantics. Verizon's full waiver definition only includes consideration of deployment for lines that were not expected to be DSL-qualified by year-end 2002. Verizon's request for a full waiver covers the incremental lines that would need to be equipped for DSL transport capabilities to satisfy the overall requirements of Section 13-517. Logically, a waiver is not required for lines that have already been (or were expected to be by year-end 2002) equipped to be DSL transport capable.

Q. Is Verizon continuing to deploy DSL transport capabilities beyond areas that were slated to have those capabilities by year-end 2002?

A. Yes, but this is not inconsistent with being granted a full waiver for these areas. A waiver does not preclude rational deployment; it just assures that irrational deployment is not mandated. As I have previously stated, Verizon is dedicated to deploying services where and when such deployment makes rational financial sense.

Q. Overall, has Verizon filed sufficient information to allow evaluation of its requested waiver?

A. Yes. Verizon submitted:

(a) projected costs of providing DSL transport services for the areas in which Verizon has not deployed or planned to deploy by year end 2002,

(b) projected revenues associated with the same areas,

(c) information sufficient to develop pro-forma financial statements, with and without the impacts of the above items (a) and (b), and

(d) the principal assumptions used in preparing the above material.

The above information is consistent with the ICC's Proposed Order regarding filing requirements associated with Section 13-517 waiver requests.[2]

Q. Dr. Zolnierek seems to agree with you that subsidized services raise various competitive neutrality issues.[3] If Verizon's DSL transport service offering (if it would be required to achieve compliance with section 13-517) is subsidized, what does Dr. Zolnierek recommend the Commission do?

A. Dr. Zolnierek has two recommendations. First, the Company's end users should not be required to face increased basic service rates, since such increases should be considered to impose a significant adverse impact on end users.[4] Second, Dr. Zolnierek proposes that Verizon should be required to support any unprofitable deployment with the "supranormal profits earned from the provision of advanced services in other areas"[5] or from Verizon's shareholders.[6]

Q. How would you define supranormal profits?

A. I would define them as profits that result from being able to exercise significant market power – which would imply that the Company has the ability to profitably charge rates above competitive market levels for a significant period of time. The key phrase here is "above competitive market levels." Supranormal profits are not based on analyzing the service's price in comparison to the incremental costs of the service; it is based on the service's price as compared to competitive market rate levels. There's no evidence that

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[2] ICC's Proposed Order, Docket 02-0699, January 15, 2003 (Proposed Order).
[3] Dr. Zolnierek's Rebuttal testimony, p. 2, line 37 – page 3, line 53.
[4] Id., p. 6, lines 121 – 126.
[5] Id., p. 6, line 134 – page 7, line 141; page 7, lines 151 – 154; page 8, lines 170 – 177.
[6] Id., p. 4, lines 77 – 89; and p. 8, lines 170 – 177,

Verizon is generating or has the ability to generate supranormal profits from its provision of DSL transport services.

Q. Does Verizon exercise any significant degree of market power in the provision of DSL transport services?

A. Although this question enters a complex area, the simple answer is no, prices for DSL transport services are regulated by the Federal Communication Commission, which assures that the Company cannot exercise any degree of market power, whether or not the Company could ever possess significant market power in the provision of the service.

Secondly, competitive alternatives do exist for DSL transport services. I would assume that Dr. Zolnierek would agree that competitive markets have the uncanny capability to target and ultimately erase any "supranormal" profits.

Q. Are Dr. Zolnierek's recommendations consistent with his concerns regarding competitive neutrality issues?

A. I do not believe so. Although Dr. Zolnierek recognized that a DSL transport service might be subsidized, his remedy is to have those support requirements be borne totally by the ILECs' shareholders, regardless of any competitive neutrality issues or any legal issues that may surround such a mandated requirement. In essence, Dr. Zolnierek's recommendations absolutely ignore the issues surrounding subsidized service offerings.

Q. Dr. Zolnierek states that subsidies are not always detrimental to societal welfare.[7] **Do you agree?**

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[7] Id., p. 3, lines 55 – 65.

A. Yes, but one must also note that the examples Dr. Zolnierek presented in his discussion on this topic were likely funded through taxpayer dollars or potentially through some form of competitively-neutral charges, neither of which Dr. Zolnierek proposes in this proceeding.

Q. ICC Staff witnesses all contend that Verizon's waiver filing has information deficiencies? Please comment.

A. The assertions of deficiencies seem to stem back to the direct testimonies of Ms. Liu and Ms. Freetly. Ms. Liu's rebuttal testimony reiterates what I believe to be her major concerns: (1) Verizon did not provide a definition of "customer"[8], and (2) Verizon was unable to provide customer segmentation[9] information by central office by form of advanced service offering[10]. Ms. Liu deems this information to be critical to determining whether or not Verizon's presentation correctly addresses the requirements of Section 13-517.[11]

Ms. Freetly's major concern deals with pro-forma financial analyses that would allow her to compute various financial ratios that she could compare against published benchmark ratios.[12] Not withstanding, Ms. Freetly was able to perform an analysis of whether or not Verizon would be unduly economically burdened based on the data that Verizon did provide.[13]

[8] Ms. Liu's Rebuttal Testimony, p. 6, lines 146 – 150.
[9] Ms. Liu's requested customer segmentation included big business customers, small business customers, and residential customers.
[10] Ms. Liu requested customer segment information stratified by type of advanced service offering: Asynchronous Transfer Mode (ATM), Frame Relay (FR), High Capacity Digital (HCD), which includes DS-1 type offerings, and DSL.
[11] Ms. Liu's Rebuttal Testimony, p. 9, lines 211 – 213.
[12] Ms. Freetly's Rebuttal Testimony, p. 2, lines 26 – 31.
[13] Id., p. 2, lines 32 – 40.

Q. Do you consider that any of these purported informational deficiencies would have any material impact on the analysis of Verizon's waiver request?

A. No. First, it is apparent from Ms. Freetly's testimony that sufficient information was provided to allow her to perform an analysis concerning Verizon's position that compliance with Section 13-517 would be unduly economically burdensome.

In terms of Ms. Liu's concerns, I believe I fully addressed the issue of the need and/or requirement for exhaustive customer segmentation data in my rebuttal testimony.[14] This information may provide someone with interesting factoids, but would not impact the overall requirements of Section 13-517, nor is this information listed as a potential waiver filing requirement in the ICC's Proposed Order.

Q. Did Verizon provide a stated definition of "customers?"

A. Not specifically, but I provided evaluations concerning compliance with Section 13-517 based on two alternative scenarios: (1) potential customers were defined as a subset of switched access lines (potential DSL lines) and the "percent of total customers" in an area is equal to the "percent of the Company's total potential DSL lines" in that area[15], and (2) number of customers is equal to number of customer bills which can then be evaluated based on relationships between bills and switched access line data.[16] The later evaluation presented extremely strong statistical data that Verizon's financial presentation is consistent with the 80% threshold required by Section 13-517.

[14] Rebuttal Testimony of Dennis B. Trimble, pp. 15 – 20.
[15] See Verizon's response to ICC Staff's Data Request QL-19 and the Direct Testimony of Dennis B. Trimble, page 20.
[16] See Rebuttal Testimony of Dennis B. Trimble, pp. 16-19.

Q. What concerns do the ICC Staff and the Attorney General witnesses have with Verizon's submitted cost estimates?

A. Both Mr. Hanson of the ICC Staff and Mr. Dunkel (representing the Attorney General) allege that Verizon included costs in the Company's financial presentation that should be eliminated. Mr. Hanson asserts that Verizon included costs for areas that already have advanced telecommunication services and thus he lowered Verizon's annual cost estimates by $16 million.[17] Mr. Dunkel asserts that Verizon's use of annual charge factors ("ACFs") results in a double counting of maintenance and other non-capital expenses.[18] Thus, Mr. Dunkel reduced Verizon total annual expense estimates by approximately $8.5 million.[19]

Q. Please comment on Mr. Hanson's assertion that Verizon included costs in its incremental financial analysis that are really associated with areas that already have DSL transport capabilities.

A. As Verizon witnesses Messrs. Slagle and White have presented in their testimonies, all costs incorporated in Verizon's financial analyses are costs only associated with geographic areas that were non-DSL transport capable based on planned deployment through the end of 2002. The costs do include expansion of capabilities in central office areas (or exchanges) that currently have DSL transport capability deployed for some percentage of the lines in that specific area. These incremental costs are appropriately included in Verizon's incremental analysis of the costs that would be incurred to be

[17] Hanson Rebuttal Testimony, page 5, lines 107-109.
[18] Dunkel Rebuttal Testimony, pp. 12 – 13.
[19] Id., pp. 13 – 14.

compliant with Section 13-517. Thus, Mr. Hanson's purported $16 million reduction in costs is not appropriate.

Q. Do you understand how Mr. Hanson derived his $16 million estimate?

A. No. Mr. Hanson provided no documentation for his cost reduction estimate. The Company has requested that the ICC Staff provide supporting documentation for the estimated reduction to ascertain how the estimate was actually computed. But, regardless of the methodology, Verizon's cost submission included only costs associated with non-DSL transport capable areas and thus was consistent with the Company's estimated incremental revenue projections.

Q. Did Verizon's cost estimates double count maintenance and other non-capital expenses as alleged by Mr. Dunkel?

A. No. The maintenance expenses associated with the required capital are correctly estimated.[20] As Mr. Slagle's surrebuttal states, the old cables would not be removed, but would continue to provide services to narrowband customers.[21]

Q. Do the annual costs that you presented in your Rebuttal Testimony include any non-capital expenses, other than maintenance?

A. Yes. The incremental ACFs that drove the development of the annual costs include an amount for customer operations expenses (e.g., marketing, sales, advertising, order processing, revenue accounting, and operator services)[22], but "all" of these costs would be "incremental" to the introduction of a DSL transport service. There are no

[20] Based on the ACFs used by Verizon, approximately $1.1 million dollars in annual maintenance/repair expenses are contained within the $51.6 million Mr. Dunkel used as annual costs.
[21] Mr. Slagle's Surrebuttal Testimony, page 4
[22] See the Fact-Finder documentation Verizon submitted in response to ICC Staff's data request FIN-1, p. 16.

inappropriate non-capital costs incorporated into the “incremental” ACFs (which were used in the Company’s cost presentation).

There are other potentially duplicative non-capital related expenses that are built into “fully allocated” ACFs, but Verizon’s cost estimates in this proceeding were not based on fully allocated ACFs.

Q. Should Verizon’s annual expense estimate of $51.6 million be reduced by $8.5 million, as recommended by Mr. Dunkel?

A. No. As discussed by Mr. Slagle and myself all of the expenses Mr. Dunkel has identified as potentially duplicative are correctly designated as incremental new expenses that are solely caused by the requirement to deploy services in order to comply with Section 13-517.

Q. Mr. Hanson also opines that alternative low cost technologies may develop which would significantly lower the cost of providing advanced telecommunication services.[23] Please comment on this statement.

A. Mr. Hanson may well be correct, but the factual truth must be for some future determination. If such cost compression does occur in the future, Mr. Hanson must realize that prices (and potential demands) are also likely to be impacted. Thus any implication that financials will be greatly improved would be mere conjecture, at best.

Q. Mr. Hanson developed two schedules that purport to revise the financials you submitted in your Rebuttal Testimony.[24] Please comment on these attachments.

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[23] Mr. Hanson Rebuttal Testimony, p. 13, lines 295 – 297.
[24] Staff Exhibit 2.1 Attach 1 and Attach 2 – Proprietary.

A. Although I have not had access to any backup material supporting all of Mr. Hanson's computations, I can easily identify what I consider to be several serious flaws that make Mr. Hanson's analyses irrelevant to this proceeding (assuming Mr. Hanson is attempting to compare "incremental" costs with "incremental" revenues). These computational flaws result in an underestimate of annual incremental costs as well as an extreme overestimate of annual incremental revenues.

First, Mr. Hanson's revenue estimates are based on an estimate of total company DSL transport revenues (including revenues from areas that were deployed or planned to be deployed prior to year-end 2002). Mr. Hanson relied on an objective requirement for DSL transport capable lines that he determined to be approximately 480,000 (which was based on 80% of "total" residential lines in the Verizon's territory). Based on this number for needed incremental DSL transport capable lines, Mr. Hanson applied penetration rates (similar to those that I proposed in the Company's financial evaluation) to determine estimated incremental annual demand units. By deriving incremental revenues from these demand units, Mr. Hanson could supposedly compare revenues with incremental expenses and ascertain the expected economic burden the Company would face due to compliance with Section 13-517.

But, what Mr. Hanson's methodology accomplished was to create an estimate of total company residential demand[25], not an estimate of the expected incremental demand in the areas for which Verizon's incremental costs were developed. Since exchange areas that are consistent with Verizon's filed incremental cost estimates account for approximately

[25] Total company demand would likely also be overestimated, since various residential customers also have addition residential lines (second lines). See Table 1R of the Rebuttal Testimony of Dennis B. Trimble.

[redacted] of Verizon's residential access lines, a rational estimate of the total residential lines in the areas consistent with Verizon's waiver request would have been approximately [redacted] versus the [redacted] Mr. Hanson used in his analyses. An 80% deployment objective would have resulted in needed incremental DSL transport capable lines of approximately [redacted] versus Mr. Hanson's assumed 480,000. Thus, Mr. Hanson's revenue estimates are at least 60% higher than they should be (in order to be consistent with the incremental cost estimates)[26].

Q. Did Mr. Hanson's demand estimates include any other curious assumptions?

A. Yes. I assumed from Mr. Hanson's attachments that he also employed the same "aggressive" annual penetration rates that I presented in my direct and rebuttal testimonies; specifically following the annual path depicted in Table 1SR.

Table 1SR

End of Year # X					
Demand Penetration %					

Mr. Hanson's "Staff Ex. 2.1 Attach 1" states that capital is deployed over two years with 25% of the capital being deployed in 2003 and 75% being deployed in 2004. Thus I assume that 25% of the needed capital was deployed at the beginning of 2003 with the remaining capital being deployed at the beginning of 2004. Based on Mr. Hanson's two-year deployment schedule and the demand penetration path presented in Table 1SR, Mr.

[26] No cost numbers were filed for areas that had or were planned for DSL transport capabilities prior to year-end 2002.

Hanson overestimated expected penetration rates in years 2004 through 2007 as depicted in Table 2SR.

Table 2SR

	2003	2004	2005	2006	2007
Mr. Hanson's Estimates					
Estimates based on Table 1SR					

These differences may seem minor, but the 2007 estimate of penetration is 10% higher than the original assumed time path for penetration rates, which adds another 10% increase to estimated revenues.

Q. You previously discussed Mr. Hanson's assertion that Verizon included incremental costs for areas that already had DSL transport capabilities deployed. Did Mr. Hanson's financial analyses also incorporate this alleged activity?

A. Again, without Mr. Hanson's supporting work papers, it's impossible to determine exactly what Mr. Hanson did to estimate annual cost estimates. But, it is apparent from "Staff Ex. 2.1 Attach 1 – Proprietary" that Mr. Hanson's methodology greatly reduced Verizon's estimated "incremental" capital requirements. Although Mr. Hanson alleged that Verizon improperly included $16 million in incremental capital, his Attach 1 exhibit reduced Verizon's estimated incremental capital by $37 million.

In addition, although Mr. Hanson's exhibit states that 25% of the capital is deployed in 2003 and the remaining 75% is deployed in 2004, the annual cost estimates presented in the same exhibit are based on deploying 25% of the capital in 2003, 50% of the capital in 2004, and the remaining 25% in 2005.

Together, these methodological quirks result in a total underestimate of incremental annual costs.

Q. Could Mr. Hanson have been attempting to perform a non-incremental financial analysis?

A. It is possible that Mr. Hanson was attempting to perform a financial analysis based on Verizon's total DSL deployment (existing and incremental). But Verizon only submitted information and analysis consistent with determining the financial impact of the going-forward deployment requirements that would be required to comply with Section 13-517. An incremental analysis is the appropriate analysis to determine the financial impact of the future deployment requirements that are the subject of Verizon's waiver request.

Q. Assuming you have a reasonable understanding of what Mr. Hanson was attempting to analyze, what revisions would you make to Mr. Hanson's "Staff Ex. 2.1 Attach 1 – Proprietary"?

A. I have attempted to incorporate most of the changes I have talked about and have incorporated those changes into Exhibit DBT-1SR. This exhibit follows Mr. Hanson's methodologies but revises his inputs to assure that "incremental" revenues are compared to "incremental" costs. The result of these revisions creates a dramatically different picture than was painted by Mr. Hanson. This fact can be best depicted by the resulting change in what Mr. Hanson has termed the "per line shortfall" (e.g., the monthly revenue deficiency per access line to comply with Section 13-517). This comparison is depicted in Table 3SR.

Table 3SR

	2003	2004	2005	2006	2007
Mr. Hanson's Estimate					
Estimate Based on Corrected Input Data (Exhibit DBT-1SR)					

As presented in both my direct and rebuttal testimonies (and again supported by Table 3SR), mandated compliance with Section 13-517 requires incremental investments that are significantly and unduly economically burdensome to either existing customers and/or the Company.

Q. Didn't Ms. Freetly base her financial recommendations on the results of Mr. Hanson's analyses?

A. Yes. But given the inconsistencies inherent in Mr. Hanson's analyses, any recommendations based on his financial analyses must be dismissed as inaccurate and inappropriate. Ms. Freetly should rely on the Company's submission as the only acceptable presentation of the potential financials impacts resulting from mandated compliance with Section 13-517.

Q. Mr. Dunkel prepared a financial schedule that indicates that full compliance with Section 13-517 would not be unduly economically burdensome to Verizon.[27] **Please comment on Mr. Dunkel's analysis.**

[27] Mr. Dunkel's Rebuttal Testimony, p. 10, line 17 – p. 14, line 6.

A. Mr. Dunkel's Exhibit WD-2, which he discusses on pages 10 – 14 of his rebuttal testimony, provides the analytic framework for Mr. Dunkel's assertion. Exhibit WD-2 was derived by altering Table 7 of my rebuttal Exhibit DBT-1R for what Mr. Dunkel alleges to be two flaws: (1) including duplicative maintenance and other non-capital expenses, and (2) elimination of revenues appropriately associated with the incremental costs that Verizon submitted.

I (and other Verizon witnesses) have already discussed Mr. Dunkel's first alleged flaw – the double counting of expenses – and no potential double counting is involved in the cost estimates submitted by Verizon.

In terms of Mr. Dunkel's second alleged flaw – the elimination of appropriate revenues – Mr. Dunkel is also incorrect. Mr. Dunkel's Exhibit WD-2 suffers from the same inconsistency as Mr. Hanson's analysis – Mr. Dunkel incorporates an estimate of projected "total" Company DSL revenues and compares that revenue estimate to the "incremental" cost to facilitate post year-end 2002 deployments. Again, I (and other Verizon witnesses) have addressed whether or not all of Verizon's filed cost estimates are "incremental" cost estimates – and the answer is "yes, they are just incremental costs." Likewise, associated revenues used in any comparison with the "incremental" costs must only incorporate revenues associated with the "incremental" capital deployment (which are the revenue streams I presented in Table 7 of my Exhibit DBT-1R).

As such, <u>none</u> of Mr. Dunkel's recommended adjustments to my exhibit are appropriate. Mr. Dunkel's misunderstanding of Verizon's filed material has resulted in him asserting conclusions that cannot be supported by rational analysis. Without his erroneous adjustments, Mr. Dunkel cannot support his allegation that serving the required 80% is profitable. Table 7 of my Exhibit DBT-1R stands as it was originally developed and it glaringly indicates that deployment to comply with the 80% rule of Section 13-517 would be financially irresponsible.

Q. Mr. Dunkel also performed an analysis based solely on deploying DSL capabilities to handle lines directly served from a central office.[28] Please comment on Mr. Dunkel's recommendations regarding this segment of customer lines.

A. Mr. Dunkel's analysis of central office – only based deployment leads him to conclude that such a deployment is profitable. Mr. Dunkel's Exhibit WD-2, which he discusses on pages 10 – 14 of his rebuttal testimony, provides the analytic framework for his assertion. This exhibit was based totally on information that Verizon has submitted in this proceeding (which included conservative cost estimates and aggressive demand estimates). This exhibit, itself, does not indicate that central office-only based deployment is profitable, it only indicates that, based on Verizon's filed assumptions, central office-only based deployment would have a positive revenue-to-cost position during 2007 (five years after capital deployment). What Mr. Dunkel conveniently omitted were the revenue-to-cost streams associated with earlier years. A positive revenue-to-cost flow in any given year does not indicate that the subject investment has turned profitable. An appropriate analysis would minimally look at the net present value of the cash flows over the revenue producing life of the capital investment.

Q. What are the estimated annual cash flows that are inherent in Mr. Dunkel's analysis?

[28] Id., p 4, line 14 – p. 10, line 15.

A. My exhibit DBT-2SR provides the estimated annuals cash flows that are consistent with Mr. Dunkel's Schedule WD-1. The annual cash flows are depicted in Table 4SR.

Table 4SR

Year	Revenue Over Cost ($000)	Cumulated Revenue Over Cost ($000)
2003		
2004		
2005		
2006		
2007		

It is apparent from the data that by year-end 2007, central office-only deployment is far from achieving recovery of its total annual costs. To term such deployment as being profitable is incorrect.

Q. Won't revenues continue to grow to the extent that cumulative revenues over cost will turn positive?

A. Based on a given set of assumptions that could potentially occur. But, in reality, the cost, price, and demand penetration assumptions the Company employed in this filing are highly optimistic, and not likely to occur. The financial analysis that was provided in this proceeding should be considered the most attractive but least likely scenario based on the assumptions employed in developing the financials. I will provide a further discussion of this fact in the next section of the testimony.

Q. Do you have any other concerns with Mr. Dunkel's analysis concerning central office only deployment based financial estimates?

A. Yes. It seems apparent from Mr. Dunkel's Testimony (page 9) that he misunderstands that if Verizon is mandated to make this capital investment, that an end user could simply call, do a "self-install", and be able to get DSL service. As I have stressed in my rebuttal testimony, the costs that Verizon has presented in this proceeding are those costs necessary for Verizon to provide DSL transport capabilities only. In order for an end user to obtain DSL service, there must be an Internet service provider (which Verizon the ILEC is not) willing to service the area. If there is no willing ISP, then the capital investment made by Verizon will result in stranded plant.

Q. Staff witness Mr. Hanson contends that Verizon is understating the number of customers that will use advanced telecommunication services.[29] Please comment.

A. Mr. Hanson is just presenting an extremely unlikely outcome that is contrary to most observed facts. Throughout my direct and rebuttal testimony, I continually advised the readers that the demand penetration estimates I employed in the financial analysis were extremely aggressive. Thus, so are Verizon's submitted financials. While Mr. Hanson contends that new and wonderful applications that will stimulate demand for broadband services may be just around the corner, those types of assumptions should not be incorporated into rational financial analyses.[30] Likewise, Mr. Hanson's statement that doubling take rates would make offering DSL service profitable is absolutely true, but such an unrealistic statement should be considered for what it is - a method to achieve self-serving results.[31]

[29] Mr. Hanson's Rebuttal Testimony, p. 6, line 126 – p. 7, line 142.
[30] Id., p. 6, lines 136 – 139.
[31] Id., p. 13, lines 288 – 291.

Q. What evidence do you have to support your assumed 5-year demand penetration rate of 17% is extremely aggressive?

A. First, I should go back to the results of the consumer surveys of rural Illinois customers performed by the Office of Economic and Regional Development, Southern Illinois University (SIU) ("Rural Illinois High Speed Connectivity Technology Development Study – Final Report", June 2002). Within that study, only 2% of the respondents that did not currently have high-speed access said they would be willing to pay $50 per month to obtain such access. This set of respondents makes up a majority of the end-users in Verizon's rural serving areas (e.g., consumers without high speed access). 2% is significantly different than 17%.

Likewise, Verizon has data regarding penetration rates throughout its various affiliate operating territories that can be used for comparative purposes. For example, based on DSL deployments that have been in service three or more years, the demand penetration of associated qualified lines in various states is depicted in Table 5SR.

Table 5SR

State	**Penetration Rate**
California	
Illinois	
New York	
Ohio	

All of these penetration rates (except California) are significantly less than the [redacted] growing to penetration rates that I assumed in Verizon's financial analysis when the deployed capital has been in-service for more than three years. Of all the areas, Verizon's non-DSL capable areas in Illinois would most likely resemble Verizon's Ohio serving territory, which has one of the lowest demand penetration rates.

Also, as I stressed in my rebuttal testimony, a very critical requirement to assure any level of demand penetration is the existence of an Internet Service Provider (ISP) willing to enter each market area.[32] Without a willing ISP, demand for DSL transport services will never materialize.

The only conclusion that one can rationally accept is that the demand penetration rates used in Verizon's financial analysis are extremely aggressive.

Q why did you elect to use such aggressive penetration rates in the development of Verizon's financials?

A. I was attempting to avoid any contentious debate regarding the appropriate level of demand penetration. Verizon's financial estimates clearly indicate that mandated deployment of DSL transport capabilities to comply with Section 13-517 would be unduly economically burdensome, even with aggressive demand penetration assumptions. But, as intervening parties begin to tweak costs or redefine segments for waiver approval, they must also be willing to overlay into their analyses more rational assumptions regarding demand penetration rates.

Q. Please summarize your testimony.

A. After reviewing the various parties' rebuttal testimonies, it is apparent that the financial analysis proposed by each party contains severe computation flaws or unsupportable

[32] Rebuttal testimony of Dennis b. Trimble, pp. 28 – 30.

conclusions that were derived based on a specific financial analysis. As such, no due consideration should be given to any recommendations based on the rebuttal testimonies filed by the various parties.

Verizon’s filed financial analyses represent the most rational view(that has been filed) of the potential adverse economic impacts to either end-users and/or Verizon that would likely occur if Verizon were mandated to comply with Section 13-517.

Upon receipt of either (a) compliance certification or (b) waiver approval, Verizon will still be committed to deploying DSL transport services in areas that are financially viable. Likewise Verizon will commit to work with communities and/or appropriate interest groups to assure that their advanced service requirements are addressed in a rational and efficient manner.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes.